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Contracts-Enforcement of Negative Covenants by Injunction

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CONTRACTS—ENFORCEMENT OF NEGATIVE COVENANTS BY INJUNCTION.—Defendant, upon entering employment of plaintiff as head salesman and branch manager, covenanted that he would not during the employment nor within eighteen months thereafter, engage in the business of selling merchandise handled by the plaintiff, either directly or indirectly, for himself or for others in any territory in which he had worked. After working for more than three years, the employment was terminated and a month later the defendant began selling merchandise of the type described in the contract. Plaintiff brought suit asking an injunction against the defendant restraining him from soliciting or diverting plaintiff's patronage. From a judgment sustaining a demurrer to plaintiff's complaint, the plaintiff appeals. Held, under the facts stated, the restraint would not be unreasonable or against public policy and the demurrer of the defendant should have been overruled. Reversed.[1]

Express negative covenants which restrict one person from competing with another or from accepting employment with a competitor, may be analyzed from the viewpoint of the subject-matter of the contract of which the covenants are a part. The division according to this classification would be:

(1) Covenants pertaining to or included in contracts of employment.
    (a) Covenants not to compete during the term of the employment.
    (b) Covenants not to compete after the termination of the employment.
(2) Covenants not to compete which are ancillary to the sale of a business or profession and its good will.

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[37] Towne v. Eisner (1917), 245 U. S. 418, 38 Sup. Ct. 158; Eisner v. Macomber (1920), 252 U. S. 189, 40 Sup. Ct. 189.

[38] Oregon Laws (1931), chap. 371, sec. 5.

[39] Sec. 236, subsec. (b), p. 492. [40] Sec. 857, p. 2483.

[41] In re Joy's Estate (1929), 247 Mich. 418, 225 N. W. 878; Hayes v. St. Louis Union Trust Co. (1927), 317 Mo. 1028, 298 S. W. 91.

[1] Grand Union Tea Co. v. Walker (1935), 195 N. E. 277 (Ind. Sup. Ct.).

In distinguishing (1a), covenants not to compete during the term of the employment, from (1b), covenants not to compete after the termination of the employment, we find the essentials to secure equitable relief somewhat different. To secure an injunction in the former situation there must be, in addition to the showing of irreparable injury to the employer and the inadequacy of relief at law, a showing that the services of the employee are of an extraordinary, peculiar or unique character, for which a substitute who will answer the purpose of the contract cannot be easily secured.[2] In this type of covenant there is ordinarily no question of illegality of the contract; it is merely the breach of a contract. If the elements just referred to are present an injunction will be granted but if not the complainant will be left to his legal remedy of damages.

There is, however, no necessity for showing any "uniqueness" of the employee's services to secure relief by injunction in cases of the violation of (1b), a covenant not to compete after termination of employment. Here the courts balance the employer's need for protection to his business and its good will against the necessity for the ex-employee to work and support himself with a view to furthering the best interests of the public. In addition to the standard requirements for equitable intervention, i. e., a showing of irreparable damage and an inadequate remedy at law, to obtain an injunction restraining the violation of this type of covenant it must be shown: (1) that the restraint is reasonably necessary for the protection of the employer's business, (2) that the restraint will not be unreasonably restrictive upon the rights of the employee, and (3) not against public policy. If all these elements are shown to the court's satisfaction the contract will be deemed not illegal and the injunction will issue.[3]

In considering the distinctions between (1b) covenants within contracts of employment not to compete after the termination of employment, and (2) covenants not to compete which are ancillary to the sale of a business or profession and its good will, we discover that while the transactions themselves or the subject-matters of the contracts are very different, yet in each case, the acts covenanted against are quite similar. In both cases the object is to guard against a threat of future competition. In spite of this similarity, however, the courts are more reluctant to enforce the negative covenant in the former situation than in the latter.[4] This tendency on the part of the courts has been criticised and it has been asserted in cases and by text writers that no distinction should exist between these two types.[5] The argument is that it is equally lawful and proper to give the employer the protection necessary to his

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[2] Lumley v. Wagner (1852), 42 English Reports 687; Philadelphia Ball Club v. Lajoie (1902), 202 Pa. 210, 51 Atl. 973; Harry Rogers Theatrical Enterprises v. Comstock (1928), 225 App. Div. Rep. 34, 232 N. Y. S. 1; Tribune Association v. Simonds (N. J. Eq. 1918), 104 Atl. 386.

[3] Grand Union Tea Co. v. Walker (1935), 195 N. E. 277 (Ind.); Edgecomb v. Edmonston (1926), 257 Mass. 12, 153 N. E. 99; Eureka Laundry Co. v. Long (1911), 146 Wis. 205, 131 N. W. 412.

[4] Williston, Contracts (1920), sec. 1643; Carpenter, Validity of Contracts Not to Compete (1928), 76 U. Pa. L. Rev. 244, 267; Kinney v. Scarbrough Co. (1912), 138 Ga. 77, 74 S. E. 772.

[5] Eureka Laundry Co. v. Long (1911), 146 Wis. 205, 131 N. W. 412; Williston, Contracts (1920), sec. 1643; A. Fink & Sons v. Goldberg (19), 101 N. J. Eq. 644, 139 Atl. 408.

business in either case.[6] On the other hand it has been forcefully maintained that there is such a difference in the nature of the interests involved as to justify this tendency on the part of the courts.[7] In the one case an agreement not to compete may be absolutely necessary that the vendee obtain the thing sold. The covenant in such case becomes an essential part of the contract of sale. On the other hand the employer is trying to protect something which he already possesses. In so far as this is being done merely to stifle competition, it would seem invalid as against public policy. Thus it would seem that where the employee has little or no opportunity for becoming acquainted with the employer's customers, the necessity for protection of the business by injunction has been reduced to the vanishing point.[8] Of course disclosure of trade secrets and the use of a written list of customers' names presents a totally different problem and is quite universally the subject of equitable intervention.[9] Notwithstanding the inherent differences it is not suggested that there should be a different rule or formula applied in these cases, but that the courts do, and properly should, consider the differences in situation of the parties, the interest sought to be protected, and the agreements involved, in the application of the rule. It is, after all, a rule of discretion and the above are quite proper for consideration in the exercise of such discretion.

As the court states in the opinion, and so far as this writer has been able to determine, this is the first time the question of a covenant not to compete after termination of employment which is embodied in an employment contract has been decided by an Indiana court. There are, however, cases relative to restrictive covenants ancillary to the sale of a business or profession. The courts of Indiana seem committed to the proposition that, where there is an express covenant not to compete which is ancillary to the sale of a business or profession, injunctive relief will be given where there is a threat of future irreparable injury to the plaintiff and damages are inadequate or impossible of accurate ascertainment or the defendant is insolvent.[10] Since the best authority holds that there is such a close analogy between these two types of restrictive covenants, the present case is apparently in line with the existing law in Indiana.

In the determination of whether the injunction will be granted, i. e., whether the essential elements as suggested have been complied with, the courts will scrutinize: (1) the territorial limitations of the restrictive covenant, (2) the extent of time for which it is to operate, (3) whether the employer might not have adequate protection by an action at law for damages.[11]

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[6] Eureka Laundry Co. v. Long (1911), 146 Wis. 205, 131 N. W. 412.

[7] Carpenter, Validity of Contracts Not to Compete (1928), 76 U. Pa. L. Rev. 244, 268.

[8] Sternberg v. O'Brien (1891), 48 N. J. Eq. 370, 22 Atl. 348; Bowler v. Lovegrove (1921), 1 Ch. (Eng.) 642; Morris v. Saxelby (1916), 1 A. C. (Eng.) 700; Menter Co. v. Brock (1920), 147 Minn. 407, 180 N. W. 553.

[9] 32 C. J. 156, sec. 211; Pomeroy, Equity Jurisprudence (1919, 4th ed.), sec. 1689; Westervelt v. National Paper & Supply Co. (1900), 154 Ind. 673, 57 N. E. 552.

[10] Baker v. Pottmeyer (1895), 75 Ind. 451; Pickett v. Green (1889), 120 Ind. 584, 22 N. E. 737; Beatty v. Coble (1895), 142 Ind. 329, 41 N. E. 590; O'Neal v. Hines (1896), 145 Ind. 32, 43 N. E. 946.

[11] Pomeroy, Equity Jurisprudence (1919, 4th ed.), sec. 1716; 32 C. J. 220, sec. 339; 67 A. L. R. 1003; Duerling v. City Baking Co. (1928), 155 Md. 280,

The rules laid down in the older cases as to what territorial limits were in restraint of trade seem to have been abandoned to a large extent. The test usually applied in the later cases is whether the territory is greater in extent than that which is reasonably necessary to adequately protect the business.[12] Since the territory in the case under scrutiny was limited to the counties in which the defendant had worked, the territory embraced was obviously reasonable.

The question of time is also decided by the rule of reasonableness. If the time provided in the contract is longer than is reasonably necessary to enable the employer to secure his interests from the competition of his former employee, the covenant becomes unduly restrictive of the employe's rights and the courts may refuse to enforce it for that reason. Whether the time is reasonable depends entirely upon the particular circumstance of the case. Many cases, quite similar in facts to the instant case, have enforced restrictions of a more limited time.[13] There are numerous other cases, quite similar as to facts, however, where the time restriction was much longer.[14]

It might be argued that the injury to the plaintiff's business caused by the defendant's competition could be rather accurately measured and so the injunctive remedy need not be resorted to. However, if an opposite result were reached, any competitor in a business such as this might induce a particularly successful or popular salesman to leave his employer and enter the employment of the competitor. This would enable the competitor to benefit from the expenses incurred in training the salesman and at the same time not give the former employer opportunity to protect his business in case of such contingency.

H. S. C.

BANKS AND BANKING—PRIORITY OF PUBLIC FUND DEPOSITS IN INSOLVENT BANKS.—Wells County Bank qualified as a public depository and therein were deposited state funds derived from sale of automobile license plates. Upon the insolvency of the bank, the state claims a preference to these funds over other creditors. The court held that the state had no preference, the court settling the question as to whether a claim due to the state, by reason of its sovereignty, is entitled to a preference over all other creditors by referring to a case previously decided in Indiana; the state, however, was given preference on grounds not pertinent to the question here discussed.[1]

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141 Atl. 542; Eureka Laundry Co. v. Long (1911), 146 Wis. 205, 131 N. W. 412; Samuels Stores, Inc. v. Abrams (1919), 94 Conn. 248, 108 Atl. 541.

[12] Kinney v. Scarbrough Co. (1912), 138 Ga. 77, 74 S. E. 772; 9 A. L. R. 1473; 1 Page, Contract, sec. 376-379.

[13] Duerling v. City Baking Co. (1928), 155 Md. 280, 141 Atl. 542 (3 months); A. Fink & Sons v. Goldberg (19), 101 N. J. Eq. 544, 139 Atl. 408 (1 year—clothing business); Axelson v. Columbine Laundry Co. (1927), 81 Colo. 254, 254 Pac. 990 (6 months).

[14] Oak Cliff Ice Delivery Co. v. Peterson (1927, Tex. Civ. App.), 300 S. W. 107, (3 years—within 5 squares of routes upon which employee had worked); Granger v. Craven (1924), 159 Minn. 296, 199 N. W. 10 (3 years—within a town of 20,000 and 20 miles thereof); Eureka Laundry Co. v. Long (1911), 146 Wis. 205, 131 N. W. 412 (2 years).

[1] State ex rel. Symons, Bank Commissioner v. Wells County Bank et al. (1935), 196 N. E. 873 (Ind.).